

“Restoring Principles to the Housing Market: A Three-Part Strategy for Sub-prime Mortgage Reform”

Securing the American Dream of Home Ownership

Hope Street Group Policy Paper | January 2008



Executive Summary

The Opportunity

As a steppingstone to the middle class, homeownership is at the core of the American Dream. Homeownership stabilizes neighborhoods, helps families and individuals build wealth, and keeps the U.S. economy strong. However, the recent mortgage crisis has decreased homeownership rates and threatens community stability. The effects of the sub-prime mortgage crisis¹ have also hurt the housing sector and threaten to slow down the broader economy.

The Challenge

Inevitably, the mortgage crisis has led to declining homeownership rates. In the last year alone, the proportion of American households that own their homes dropped by 0.8%, the biggest year-over-year decline since 1981-82.² In 2006, the U.S. experienced its highest foreclosure rate since the Great Depression, and it is estimated that another 2.2 million households with sub-prime loans will face foreclosure in the coming years.³

Foreclosures are expensive for lenders to process, financially and emotionally devastating to families, and unsettling to neighborhoods. Communities across the country have begun to feel the effects of the sub-prime lending crisis. As the crisis has spread, so has blight, altering the identity of many neighborhoods.

America's homeowners and communities need relief. Without swift action, millions of Americans will be at risk of losing their homes, including a disproportionate share of minority families, who were only recently able to achieve the dream of homeownership.

The Solution: Assist, Protect & Prevent

A comprehensive policy response to this crisis will look beyond short-term solutions to find ways to reverse this decline in homeownership rates. This set of policy proposals will focus on financially responsible homeowners or victims of mortgage lending fraud and will:

- ***ASSIST those Americans who have already lost their homes.*** The federal government should assist individuals by ensuring access to capital and supporting state and local affordable housing and financial counseling efforts. Additionally, the government should assist communities by expanding the New Markets Tax Credit and creating a Neighborhood Improvement Emergency Fund.
- ***PROTECT current homeowners who are at risk of losing their homes to foreclosure.*** The government should allow borrowers to extend the period of their loans beyond thirty years and enact the Family Foreclosure Rescue Corporation.
- ***PREVENT unprincipled lending practices used by some mortgage brokers.*** The government should outlaw pre-payment penalties and loan acceleration on homesteads, create a national standard that modifies home equity lending, and increase federal oversight for mortgage brokers and companies.

Policy Design

Recommendation #1: Assist those who have already lost their homes.

The federal government should focus its efforts to assist individuals whose homes have been foreclosed and communities that were hard-hit by waves of foreclosure.

Assisting Individuals. People facing foreclosure lose a great deal of their wealth in the form of equity in their homes and significant damage to their credit scores, making it nearly impossible to be approved for any type of loan or home mortgage in the near future. The federal government should assist those who have already faced foreclosure by:

- **Urging banks to ignore fraud-induced foreclosure in determining home loan eligibility.** Some homeowners are at risk of foreclosure because of fraudulent business practices. For example, a mortgage lender may have artificially reduced an applicant's expected monthly expenses by relying on the unimproved property tax value before a new home was constructed. In this instance, it seems appropriate that there would be an industry-wide response. One precedent for such action can be found in New Orleans, where banks ignored the effects of Katrina on borrowers' ability to stay current on payments, and extended additional credit. If banks and mortgage lenders adopt this policy for fraud-induced foreclosure victims, the industry can be seen as the solution rather than the culprit. There is also a potential for public-private partnership. The government can participate by subsidizing the interest on new loans for fraud victims or guaranteeing a portion of the loans, similar to the role the federal government currently plays in higher education funding. The government should put a cap on the dollar amount of loans to be guaranteed to limit exposure.
- **Partnering with state and local community organizations to provide financial counseling.** Whether or not an individual who went through foreclosure decides to own a home again, s/he will need financial counseling to restore his/her credit. Many sub-prime borrowers did not understand the full depth of the financial terms and obligations of their loan. Therefore, local community organizations, with support from federal and state governments, should host financial counseling sessions for each individual seeking assistance. Furthermore, the government should work with various advocacy groups to provide pre- and post-purchase financial counseling to households facing foreclosure. Housing researchers have demonstrated that quality pre-purchase training of homebuyers significantly reduces subsequent mortgage delinquencies.⁴ Post-purchase counseling and foreclosure assistance programs have the potential to prevent many delinquencies from turning into foreclosures. The government, lenders, and advocacy groups should form partnerships to increase resources to thoroughly expand financial literacy and homeownership counseling.
- **Supporting existing state and local affordable housing initiatives.** Many cities currently operate affordable housing programs, which easily can be expanded to include the victims of predatory sub-prime mortgage lending. Current programs include down payment assistance, community land trusts, and silent loans⁵ for qualified, low-income or low-credit borrowers. The federal government should identify best practices in affordable housing programs and encourage state governments to adopt and fund such programs in desired development regions.

Assisting Communities. While individuals have lost equity and quality of life, dense concentrations of foreclosure also negatively impact entire communities. Lenders frequently try to auction foreclosed homes or sell them at a discount, which can destabilize housing prices in a community. Further, increased foreclosure rates have been linked to increased crime, lowered school performance, and various local tax burdens. In short, many upstanding homeowners are

being negatively impacted by the excesses of unprincipled lenders and irresponsible borrowers. The federal government can help assist revitalization efforts in hard hit areas by:

- ***Creating a Neighborhood Improvement Emergency Federal Fund.*** This fund would be used to help local communities cope with the short-term, financial and social costs of high rates of vacant properties caused by a surge of foreclosures. The Neighborhood Improvement Emergency Fund would be provided to states and localities in the form of block grants, therefore each city/community would be able to establish its specific need. The grant money would be allocated to communities needing assistance for a variety of purposes, including increased policing and cosmetic maintenance.
- ***Provide tax incentives under the New Markets Tax Credit (NMTC).*** Currently the NMTC is awarded to taxpayers making equity investments in Community Development Entities, which make investments in low-income communities.⁶ We propose that Community Development Entities should be expanded to include organizations that use investment funds in areas that suffer from foreclosure above a certain rate. As a basis for comparison, in August 2007, the top ten metro area foreclosure rates were 2% and above.⁷ The hardest-hit areas can be defined finely by using census tracts or zip codes to ensure appropriate targeting. Other than adding foreclosure rates as an eligibility rule, the same rules and applications would apply under the NMTC.

Recommendation #2: Protect current homeowners who are at risk of losing their homes to foreclosure.

Roughly 1.8 million American households are at risk of losing their homes because of escalating monthly payments that are no longer affordable. Some are suffering as a result of adjustable rate mortgages (ARMs), which allow a buyer to purchase property at an initially reduced “teaser” interest rate that increases sharply after a few years. Others are at risk because of leveraging too much equity from their homes, which may have been borrowed to pay off debt, purchase other assets, subsidize home improvements, or finance health or educational expenses. If all those at risk do default on their mortgages, there will be ripple effects throughout the American economy.

The federal government can help protect those at risk of default in two ways:

1. ***Modify the finance period of existing loans.***⁸ Hope Street Group recommends extending the finance period on ARMs by a 5 or 10-year period. Extending the length of the loan would reduce a homeowner’s monthly payment at the same time that it could increase interest payments to investors over the life of the loan. Because total interest payments would not be negatively impacted, private lenders should be more willing to adjust at-risk loans and avoid future government intervention. Further, such a proposal could address the mortgage crisis without passing costs on to taxpayers.
2. ***Support the Family Foreclosure Rescue Corporation (FFRC).*** Modeled after Roosevelt’s Home Owners’ Loan Corporation, the successful New Deal program that protected homeowners from delinquency, default, and foreclosure, the FFRC would offer new fixed-rate mortgages to borrowers that are effectively precluded from refinancing because of negative home equity caused by declining prices. For example, to finance the FFRC, the government would sell \$150 billion worth of revenue bonds with an annual yield of 5% to purchase non-performing mortgages at a discount and to provide homeowners with mortgages at rates not to exceed 7.5%.⁹ This program could provide a stable revenue source for mortgage refinancing. Implementing the FFRC would directly help at-risk borrowers, stabilize neighborhoods by preventing widespread foreclosures, and potentially could restore liquidity to the capital markets from the bottom up.

Recommendation #3: Prevent unprincipled lending practices used by some mortgage brokers.

Sub-prime lending enabled many households to qualify for mortgages that were previously out of reach.¹⁰ If lenders and borrowers behave responsibly, sub-prime lending can be a positive addition to the mortgage markets and our economy, yet in the past two years we have seen the housing market crumble due in part to the exploitation of such loans. Therefore, it is necessary that government, the private sector, and advocacy groups work together to develop safeguards and standards that prevent further misuse of sub-prime lending by taking the following steps:

- ***Outlaw pre-payment penalties and loan acceleration on primary residences.*** One of the chief roadblocks to implementing a government intervention is the proliferation of early payment penalties on home mortgages. Such penalties make it difficult for homeowners to refinance their property in order to take advantage of reductions in interest rates or rising equity in their homes. We believe all Americans should have equal access to their home's equity and should be equally able to respond to changes in the economy through refinancing.

In addition, the government should outlaw the practice of accelerating loan payments due to market value fluctuations or because a homeowner has gone into default on other, unrelated indebtedness. Many states currently provide these protections to homeowners, and we believe it should be adopted at the national level.

While some may suggest focusing on reducing pre-payment penalties and loan acceleration clauses on existing residential loans, we believe it is more prudent for the federal government to focus on preventing this practice from continuing in the future by outlawing pre-payment penalties on all new home loans issued.

- ***Modify home equity loans.*** Not all homeowners at risk of default were stung by sub-prime mortgages. Rather, one contributing factor was the increased popularity of home equity loans. While this financing vehicle has buoyed consumer spending in recent years, ultimately it has led to exponential housing price increases and left many Americans over-extended in housing markets that are upside-down. We have three recommendations for reforming home equity loan lending:

1. ***Only allow homeowners to capture home equity once per 12 month period.*** Much like refinancing student debt, homeowners should be limited in the number of times they can capture home equity.¹¹ This will reduce the first lien-holder's exposure to risk and ultimately protect homeowner from fluctuations in the market.
2. ***Set a national "cash out" limit of 80% of appraised home equity each year.*** Across the country, states have varying rules about how much appraised equity can be captured during a single refinance or home equity loan transaction. Some states allow borrowers to take out up to 90% of appraised home equity each year, which does not adequately protect homeowners from fluctuations in the housing market, since prices can fall between 10% and 20% in areas hard-hit by foreclosures.¹² Instead, the federal government should set a national "cash out" limit of 80% of appraised home equity each year.¹³ Further, the federal government should encourage state licensing and certification boards to more closely oversee and monitor appraiser business practices.
3. ***Prevent equity borrowers from refinancing with riskier home loan products.*** When borrowers capture home equity, they should not be allowed to refinance into a negative amortization loan. Instead, homeowners should be required to refinance into a

more traditional fixed or adjustable-rate mortgage in order to guarantee their long-term debt-service stability.¹⁴

- ***Eliminate Yield Spread Premiums (YSP).*** Lenders pay mortgage brokers a fee as compensation when a loan closes, a portion of which may be in the form of YSP, which is a cash bonus for brokers that have persuaded borrowers to take higher interest loans. Since the brokers do not have risk in the loan performance, this compensation structure provides incentives for brokers to steer borrowers into higher interest rate loans and products than the borrowers might have qualified for. As a result, borrowers may be encouraged to take out unaffordable loans that increase their likelihood of default. The elimination of YSP would help end the deceptive lending practices that have led to many foreclosures.
- ***Increase Federal Oversight of Mortgage Brokers and Companies.*** The mortgage industry currently is governed by state regulations and federal rules in the Home Ownership Equity Protection Act (HOEPA). However, the regulations in place today have not sufficiently provided protections for borrowers. A self regulating organization (SRO) should be set up to govern mortgage brokers and brokerage companies. This SRO would be an independent governing body for the industry, with oversight from the Federal Reserve. This system would be similar to the NASD, a SRO that serves as the governing body for stockbrokers. Mortgage brokers, like stockbrokers, provide important financial advice that has national economic implications and therefore, an oversight system similar to the stockbroker industry is necessary. We recommend a SRO oversee the industry using these guidelines:
 - ***Create a national licensing system:*** This would require mortgage brokers to complete educational programs and pass licensing exams. The additional barriers to entry into the industry would help weed out the unqualified, discourage unprincipled applicants, and improve the quality of the industry. We further recommend creating a licensing board to investigate complaints and to enforce rules and penalties within the industry.
 - ***Create a national registry for brokers and companies:*** Such a registry would enable the government to collect complaints and to develop track records for all participants in the industry in a central location. It would also serve consumers by creating a national database that could be used as an evaluation tool for choosing prospective brokers and brokerage companies. The registry also would make it harder for rogue brokers and operations to jump from state to state.
 - ***Fiduciary responsibility:*** Mortgage brokers should have fiduciary responsibilities to their clients. Much like stockbrokers' work on behalf of the financial interest of their clients, mortgage brokers should have to protect the borrower's best interest in a lending transaction. Such a measure would encourage mortgage brokers to act more prudently on recommendations to consumers and would provide more recourse for a homebuyer who was the victim of unprincipled lending practices.

Economic Analysis

Recommendation #1: Assist those who have already lost their homes.

- ***Partnering with state and local community organizations to provide financial counseling.*** Many community organizations offering financial counseling and literacy classes are overwhelmed, lacking the appropriate resources to adequately provide services to all who need them.¹⁵ Additionally, one of the primary challenges these organizations have is reaching out to people that are most likely victims or potential victims of fraud.¹⁶ Therefore, the government should provide \$1 billion in the form of block grants for state and local community

organizations.¹⁷ The grants would be used to increase financial counseling and literacy efforts ranging from increasing resources and counselors to developing an enhanced marketing scheme to effectively reach the targeted people.

- **Creating a Neighborhood Improvement Emergency Federal Fund.** Communities are being negatively impacted by the mortgage crisis, with foreclosures leading to depressed property values, subsequent increases in the tax rate, and an increase in crime. Hope Street Group proposes a \$1 billion Neighborhood Improvement Emergency Federal Fund be created to provide block grants for communities being impacted by high foreclosure rates. The fund would provide communities an opportunity to apply for a grant to address varying community needs, whether for additional policing of a neighborhood or for cosmetic maintenance, such as boarding up windows or clearing refuse from an abandoned property.
- **Provide tax incentives under the New Markets Tax Credit (NMTC).** Currently the NMTC is funded at \$3.9 billion.¹⁸ Our proposal simply recommends expanding the eligibility pool for the NMTC to include investors who help organizations that provide foreclosure assistance in low-income communities. Therefore, this recommendation should be funding neutral.

Recommendation #2: Protect current homeowners who are at risk of losing their homes to foreclosure.

- **Modify the finance period of existing loans.** In contrast to current proposals recommending mortgage lenders freeze teaser rates, Hope Street Group recommends extending the finance period on ARMs as a potential boon for homeowners and investors alike.

Table 1.1 - Financial Impact of Extending the Finance Period on an Adjustable Rate Mortgage (in 2007 dollars)¹⁹

| LOAN INFORMATION: | 5-YR Teaser | plus 25-YR Adjustable | plus 30-YR Adjustable | plus 35-YR Adjustable |
|-----------------------------------|--------------------|------------------------------|------------------------------|------------------------------|
| Mortgage Amount | \$225,000.00 | \$208,036.02 | \$208,036.02 | \$208,036.02 |
| Starting Interest Rate | 5.500% | 6.591% | 6.591% | 6.591% |
| Starting Monthly Payment | \$1,277.53 | \$1,416.53 | \$1,327.40 | \$1,269.89 |
| Total Payments | \$76,651.80 | \$478,929.28 | \$572,277.75 | \$679,052.89 |
| Interest Paid | \$59,687.82 | \$270,893.28 | \$364,241.75 | \$471,016.89 |
| Total Interest | \$59,687.82 | \$330,581.10 | \$423,929.57 | \$530,704.71 |
| Additional interest for investors | na | na | \$93,348.47 | \$200,123.61 |
| Maximum payment | \$1,277.53 | \$1,760.11 | \$1,804.10 | \$1,855.85 |

- **Create the Family Foreclosure Rescue Corporation (FFRC).** The FFRC would be funded through the sale of revenue bonds (\$150 billion in our earlier example), which would not negatively impact general revenue. Rather, because the FFRC would finance fixed-rate mortgages at an interest rate above the yield of the bonds sold, the program could potentially generate additional revenues to be used for mortgage-related expenditures in future years.

Recommendation #3: Prevent unprincipled lending practices used by some mortgage brokers.

- **Increase Federal Oversight of Mortgage Brokers and Companies.** There will be added costs to establish a self regulating organization (SRO), a national licensing board, and a national registry. Rather than require taxpayers to absorb these costs, Hope Street Group recommends raising these funds from brokers and brokerage companies through annual licensing and exam fees. In essence, the SRO would be member financed.

- ***Eliminate Yield Spread Premiums (YSP).*** Mortgage brokers argue that they use YSP to subsidize points and fees on a loan in order to create “no point” and “no fee” loans for borrowers. As a result of eliminating YSP, these “no point” and “no fee” loans would likely be eliminated, which could present fewer choices for borrowers. Still, qualified borrowers could opt for a higher rate loan in order to finance the point and fees, which would eliminate the need for YSP to help pay for it.

Political Discussion

The sub-prime mortgage loan industry has been the topic of debate in recent months across the public and private sectors. Federal agencies, such as the Federal Housing Administration (FHA), have been subject to new roles to reduce the financial strain by refinancing defaulted sub-prime loans. Addressing the mortgage crisis is poised to be a key topic in the 2008 Presidential campaigns. The intensity of the mortgage crisis is damaging America’s economy, and the public is demanding an efficient government response. It is evident that solutions are being considered in certain government agencies, with both Democrats and Republicans acknowledging an urgent need to mitigate the effects of some defaulting sub-prime loans. Disagreements between the parties are mostly focused on the extent of government regulation in the sub-prime mortgage industry and the capacity of government and lenders to “bail out” at-risk households.

The government historically does not assist victims of fraud or crime, such as Ponzi schemes or identity theft. However, the government should make an exception for fraud-induced foreclosure because homeownership is the cornerstone of an individual’s financial foundation. Often it is the source of wealth for retirement or college education. When individuals cannot financially manage their own retirement, the burden may fall on already over-stretched government resources, such as Social Security. At a community level, just as foreclosure has a ripple effect that induces neighborhood abandonment and resulting property tax drains, homeownership builds up a community and creates a stable base of property taxes.

Hope Street Group has crafted a bi-partisan proposal that recognizes how crucial homeownership is to individual economic opportunity and our shared prosperity as a nation. Helping Americans who have lost, or on the verge of losing, their homes is a cause that policymakers from across the political spectrum can get behind. Hope Street Group believes that while many Americans have lost their homes or are facing foreclosure, the federal government is not obligated to assist everyone. Some Americans simply over-extended themselves to buy homes or haphazardly used equity to support lifestyles they could not afford. Extending help to this group of borrowers simply rewards financial irresponsibility. On the other hand, some Americans have been financially responsible but were targeted by unprincipled mortgage professionals. Federal assistance to this group of Americans is not a “bail out” because their history of financial responsibility was interrupted by intentional fraud by a third party.

The federal government should use the following guidelines to determine who is eligible for assistance:

1. ***A demonstrated history of financial responsibility:*** because most of those with sub-prime mortgages will have low credit scores, the federal government should only extend help to those who are current on payments for their mortgage, federal and state taxes, or other loans or lines of credit.
2. ***Income suggests financial need:*** household income should be no higher than 120% of the area median income.²⁰
3. ***Primary residence:*** the borrower must own only one home and that home must be the borrower’s primary residence and have only one lien against it. Investors that took advantage of exotic mortgage products should not be helped.

4. **Victims of fraud:** those that can demonstrate they were victims of fraud, such as efforts by mortgage brokers to qualify them for loans they could not afford, tax valuations for unimproved property, or dishonest appraisals that allowed for larger loans.

Rebuttals

“It seems to me that a lot of these homeowners were just irresponsible. Why should the government get involved in this crisis at all?”

Response: The government has a responsibility to respond to the crisis for five reasons:

- 1) *Some of those facing foreclosure are victims.* Some mortgage brokers specifically targeted borrowers for their vulnerability, such as new immigrants with limited English skills, elderly widows living alone, low-income households and/or communities of color. In addition, many loans were based on the perceived value of the house, rather than an assessment of the borrower’s ability to repay.
- 2) *Individual foreclosures often become foreclosure contagions* that turn a vibrant community of owners into a community of neglect.
- 3) *Foreclosures will negatively impact entire cities and states* as falling home values result in decreasing tax revenues or increases in tax rates to ensure government services.
- 4) *The current mortgage subprime problem has limited liquidity in the financial market and threatens to pull the entire economy into recession.*
- 5) *Without reform, we are destined to repeat the mistakes that led to the current crisis,* which has hurt everyone from Wall Street investors to individual homeowners.

“This proposal would cost a lot of money and create new government bureaucracy.”

Response: While some of our proposals will cost money, most of the costs associated with these proposals will be paid for by affected borrowers, bond financing, and mortgage broker licensing fees. Still, some costs are necessary to prevent the American economy from further suffering as a result of the mortgage crisis, which has already resulted in decreasing property values and a contraction of capital markets. If left unchecked, communities could see increasing property tax rates and an increase in crime in areas most affected by foreclosure. Investments in these proposals today will ultimately protect against costs to the government and American citizens in the future.

“Responsible homeowners are not affected by the sub-prime crisis so there is no need to contribute funds to help communities.”

Response: Many communities are being hit hard by the foreclosure crisis, turning once lively communities into neighborhoods of abandoned properties. Foreclosures can pull down all property values in the area and are associated with increases in violent crime and decreases in educational performance. As property values decrease, cities and states are likely to raise property tax rates to make up for budget shortfalls. Further, cities hardest hit by foreclosure may be hard-pressed to attract economic development activity to the region.

“Pre-payment penalties exist for a reason and eliminating them would only hurt investors in the long run.”

Response: A pre-payment penalty or fee can serve a legitimate purpose to protect the yield expectation of investors. Loan applicants, especially sub-prime borrowers already pay a

premium for their mortgages, by absorbing higher fees and interest rates, and should not face additional obstacles to finance the purchase of a home. Pre-payment penalties make it difficult for borrowers to access capital, since it makes it unaffordable to refinance at a better rate or capture home equity. Further, many states already outlaw pre-payment penalties on primary residences, and we believe it should be federal policy.

“Extending the finance period of home mortgages is too risky for lenders and investors.”

Response: While extending loan finance periods could open lenders and investors to a higher risk of default, it has become more common in the lending industry to finance loans over a 40-year period, especially in high-price housing markets. As lenders and investors take on more risk, they could be rewarded by additional returns, since longer finance periods would result in the collection of more interest payments over time. By extending the finance periods on existing ARMs, lenders and investors could collect more interest than they were expecting in the original terms of the loan. Furthermore, extending the finance period of the loan might make investors more likely to ensure that investors receive their expected rates of return.

“Independent mortgage brokers are already regulated by state institutions, therefore mandating further regulations is too burdensome and costly to implement.”

Response: Mortgage brokers are supposed to be regulated by state institutions, but due to lax licensing requirements and mortgage scrutiny, many independent mortgage brokers have fallen through the cracks and willingly participated in unprincipled mortgage lending. Hope Street Group proposes creating a self-regulating organization, which would be financed by mortgage brokers through the licensing and registry system. While these costs could be passed on to consumers, the license and registry would be credible sources consumers could check, would establish more professionalism within the industry, and would represent a real value to mortgage seekers.

About Hope Street Group Policy Papers

Hope Street Group is a new generation of leaders dedicated to building an Opportunity Economy. We build diverse coalitions from our network of business, civil society and political leaders to drive innovative policies that make social and economic mobility possible for all Americans. Hope Street Group Policy Papers are written by volunteers supported by Hope Street Group staff. Papers typically synthesize positions from think tanks of the left and right, and are intended to be user-friendly tools for busy decision-makers to more easily promote opportunity and prosperity. To learn more, visit www.hopestreetgroup.org.

¹ Note: “Sub-prime” is being used throughout this paper, though the industry term is “non-prime,” which includes Alt-A and other mortgages. General points will pertain to the non-prime category of mortgages broadly.

² Bob Willis, “US Homeownership Falls in Longest Slide Since 1981,” *Bloomberg.com*, (October 26, 2007). Online. Available: <http://www.bloomberg.com/apps/news?pid=20601087&sid=aCQTBFHpiUHk&refer=home>. Accessed: December 12, 2007.

³ Keith Ernst, Kathleen Keest, Wei Li, and Ellen Schloemer, “Losing Ground: Foreclosures in the Sub-prime Market and their Cost to Homeowners,” *Center for Responsible Lending*, (2006). Online. Available: <http://www.responsiblelending.org/issues/mortgage/research/page.jsp?itemID=31217189>. Accessed: January 15, 2008.

⁴ Katy Jacob, Sharyl Hudson, and Malcolm Bush, “Tools for Survival: An Analysis of Financial Literacy Programs for Low Income Families.” *Woodstock Institute*, (January 2000). Online. Available: <http://woodstockinst.org/document/toolsforsurvival.pdf>. Accessed: January 10, 2008.

⁵ “Silent loans” are municipal financial assistance tools that typically provide first-time homebuyers with gap financing to pay a down payment or closing costs. Unlike a more typical 80-20 loan, silent loans are a deferred payment loan, with a 30-year term that only comes due when the first lien is paid off or the homeowner moves.

⁶ The credit provided to the investor totals 39% of the cost of the investment and is claimed over a seven-year credit allowance period. In each of the first three years, the investor receives a credit equal to 5% of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the credit is 6% annually. To be eligible for the NMTTC, a Community Development Entity must be a domestic corporation or partnership at the time of the certification application; demonstrate a primary mission of serving – or providing investment capital for – low-income communities or low-income persons; and maintain accountability to residents of low-income communities through representation on a governing board of or advisory board to the entity.

⁷ Les Christie, “California cities fill top 10 foreclosure list,” *CNNMoney.com*, (August 14, 2007). Online. Available: http://money.cnn.com/2007/08/14/real_estate/California_cities_lead_foreclosure/index.htm. Accessed: December 15, 2007.

⁸ Traditional residential home loans are typically amortized over 15 and 30-year terms, while a standard 5-1 ARM is amortized for 5 years at a locked interest rate and then for 25 years at a variable rate. It has been widely recommended that the federal government freeze loan introductory rates on the most default-prone adjustable-rate loans, but doing so would open the federal government to lawsuits from investors looking to protect their financial interest. As a result, the Bush Administration has recommended that financial institutions provide at-risk homeowners the option of locking in their introductory or “teaser” rates for five years, but participation is not compulsory. Still, such a plan is a quick fix at best, leaving financial markets open to future risk since homeowners may not be able to pay higher rates at the end of the five-year period. Further, artificially locking introductory rates would unfairly penalize investors in mortgage-backed securities, many of whom are retirees or fund managers for government and corporate pensions. See Ellen Simon, “‘Virtually impossible’ to determine if pension plans hold mortgage-backed securities,” *CNBC*, (December 11, 2007). Total pension fund investments in mortgage-related securities appear to be substantial, according to Credit Suisse, which estimates that government pension plans hold \$195 billion in mortgage-related securities. Corporate plans hold another \$175 billion, according to the report. Online. Available: <http://www.cnbc.com/id/22203019/for/cnbc>. Accessed: December 14, 2007.

⁹ When state or municipal governments issue bonds, typically bondholders bear the risk. Since the FFRC would be backed by federal bonds, the government would bear the risks of default. Still, since federal bonds would bear 5% interest and the FFRC could offer loans at as much as 7.5%, we believe there would be enough of a point spread for the government to tolerate some default.

¹⁰ Sub-prime loans expanded to 20% of the mortgage market in 2006, from 9% a decade earlier.

¹¹ Several states currently restrict homeowners from taking out home equity loans on their property more than once a year and this should be federal policy as well. This practice protects both homeowners and money lenders by ensuring that borrowers do not take out additional loans based on sudden spikes in housing prices. While housing prices may increase, there is also a danger that housing prices can fall, leaving homeowners unable to cover their financial obligations by selling the property if they default on the loan. Each time a homeowner captures home equity, s/he puts himself and the lender at risk.

¹² Kathleen Howley, “U.S. Mortgages Enter Foreclosure at Record Pace,” *Bloomberg News*, (June 14, 2007). Online. Available: <http://www.bloomberg.com/apps/news?pid=206101087&sid=aLwz4ThaWzAg&refer=home>. Accessed: December 15, 2007.

¹³ For example, a homeowner with a property valued at \$100,000 and a remaining principal balance of \$20,000 would be able to capture a maximum of \$64,000 in equity.

¹⁴ Many homeowners took out home equity loans while carrying a negative amortization loan. Risky borrowing habits were reinforced by rising housing prices, low interest rates, and the assumption that borrowers would have enough money to cover minimum monthly payments or equity to refinance their loans in the future. As interest rates rose, many homeowners were unable to keep up, but were provided additional capital through home equity loans even though their home equity was in flux.

¹⁵ Rob Quercia, Lucy Gorham, and William Rohe. “Sustaining Homeownership: The Promise of Post Purchase Services.” *Housing Policy Debate*, Fannie Mae Foundation, vol. 17, issue 2 (2006).

¹⁶ *Ibid.*

¹⁷ In comparison, the HOME Investment Partnerships Program currently provides approximately \$2 billion to states annually to create affordable housing for low-income households. See also U.S. Department of Housing and Urban Development, “HOME Investment Partnerships Program.” *Homes & Communities*. Online. Available: <http://www.hud.gov/offices/cpd/affordablehousing/programs/home/index.cfm>. Accessed: December 20, 2007.

¹⁸ US Treasury Department. “New Markets Tax Credits Program,” *Community Development Financial Institutions Fund*. Online. Available: http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5. Accessed: December 19, 2007.

¹⁹ This table assumes an ARM with 60 months before the first adjustment, 12 months between adjustments, an expected adjustment of .25% each time, and an interest rate cap of 12%. This table is based on calculations made

through KJE Computer Solutions, LLC, *Financial Calculators*. Online. Available:
<http://www.dinkytown.net/java/MortgageAdjustable.html>. Accessed: December 14, 2007.

²⁰ The National Housing Center defines “working families” as those earning the equivalent of the minimum wage up to 120% of the area's median income, and have one or more children under the age of 18 in the house. As of 2005, there were 19.8 million working families with children, and in 2003 the homeownership rates for them lagged almost 10% behind that of the nation overall, with even larger gaps between white families (70.5%), Hispanic (42.5%), Black (44.6%) and Asian (55.6%).